

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-31932

MEDEX REGIONAL LABORATORIES, LLC

Debtor

THE OFFICIAL UNSECURED CREDITORS COMMITTEE
OF MEDEX REGIONAL LABORATORIES, LLC

Plaintiff

v.

Adv. Proc. No. 03-3201

WELLMONT HEALTH SYSTEM,
GARY L. ADELSON, G. ROBERT AINSLIE,
ELIZABETH B. BROWN, JANET BROWN,
EDWARD G. BUSH, PETER F. GALE,
EDDIE ALLEN GEORGE, MARCUS CLARK GRIMES,
PAT HICKIE, MICHAEL EUGENE LADD,
GEORGE MACIONE, STEVEN NEWMAN,
ED OLLIE, RICHARD RAY, FIELDING ROLSTON,
T. ARTHUR SCOTT, and PAUL J. SIDES

Defendants

**MEMORANDUM ON MOTIONS OF DEFENDANTS STEPHEN NEWMAN
AND EDWARD G. BUSH TO DISMISS FOR FAILURE TO STATE A CLAIM UPON
WHICH RELIEF MAY BE GRANTED, OR IN THE ALTERNATIVE,
MOTIONS FOR MORE DEFINITE STATEMENT**

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding is before the court upon the Complaint filed by the Official Unsecured Creditors Committee on December 3, 2003, requesting a judgment against the Defendants in the amount of \$15,000,000.00 for breach of fiduciary duty, breach of the duty of care and loyalty owed by the Defendants to the Debtor, abdication of responsibilities, breach of contract, negligent supervision, negligent promotion, negligent hiring, conversion, and negligence, stemming from their positions as governors and managers of the Debtor and conduct engaged in prior to the Debtor's Chapter 11 bankruptcy filing.

On February 27, 2004, Defendants Stephen Newman¹ and Edward G. Bush each filed a Motion to Dismiss for Failure to State a Claim Upon Which Relief May be Granted, or in the Alternative, Motion for More Definite Statement (Motions). In support of their Motions, Newman and Bush assert that the Complaint fails to allege specific factual allegations of negligence on their part, and instead, alleges only non-specific allegations, inferences, and unwarranted legal conclusions. On March 9, 2004, the Plaintiff filed its Plaintiff's Response in Opposition to Steven Newman's Motion to Dismiss or for More Definite Statement and its Plaintiff's Response in Opposition to Edward Bush's Motion to Dismiss or for More Definite Statement (Responses).

¹ This Defendant is identified by the Plaintiff in the Complaint as "Steven" Newman.

I

The following facts were obtained from the averments set forth in the Complaint. For purposes of the present Motions, they are deemed correct. *See Bruce v. Coopers & Lybrand, C.P.A.*, 272 F.3d 356 (6th Cir. 2001).

The Debtor was created in April 1999, through the filing of Articles of Organization with the Tennessee Secretary of State. The Operating Agreement was executed on October 1, 1999, and the organizational meeting was held on February 9, 2000. The Defendants, Adelson, Brown, Gale, George,² Grimes, Hickie, Macione,³ Ollie, Rolston, Scott, and Sides each served as a member of the Debtor's Board of Governors (Board) at some point between April 1999 and April 8, 2003, the date upon which the Debtor filed its Voluntary Petition under Chapter 11 of the Bankruptcy Code. Additionally, Adelson, Grimes, and Rolston served as the Debtor's Secretary, Chairman, and Vice Chairman, respectively.

The Defendant Ainslie served as the Debtor's President from April 1999 until November 19, 1999. The Defendant Bush served as the Debtor's Chief Operations Officer from February 9, 2000, until January 24, 2001, at which time he began serving as Chief Innovation Officer. The Defendant Ladd began serving as the Debtor's Chief Financial Officer in August 2000, and he became Chief Technical Officer and Chief Executive Officer in

² George is the President and Chief Executive Officer of the Defendant Wellmont Health System, which had the power to elect four of the eight members of the Board. On April 8, 2003, Wellmont bought all other interests of the Debtor and became its sole owner. It is now entirely in control of the Board.

³ Macione was also a member of the Debtor's Audit Committee from April 1999 until May 2000.

November 2001. The Defendant Newman served as Director of Sales and Marketing beginning on November 19, 2001. The Defendant Ray worked in a contract position from April 2002 until November 1, 2002, when he took over as Chief Financial Officer.

In its Complaint, the Plaintiff alleges that the Defendants each owed a fiduciary duty of care to the Debtor and its owners, which was breached by failing to oversee the actions of the Debtor's officers and by their negligent hiring of Ladd. It is averred that Ladd, while serving as the Debtor's Chief Financial Officer, unilaterally obtained unauthorized loans and implemented an unauthorized expansion of the Debtor, forged signatures of Board members, and converted approximately \$200,000.00 in company funds for his own use. For their part, the Plaintiff alleges that the Defendants did not ensure the accuracy of financial statements, did not implement a "checks and balances" system over Ladd's duties, did not create committees mandated by the Operating Agreement, did not enforce spending provisions of the Operating Agreement, did not timely procure external financial audits, did not regularly attend Board meetings, and did not properly manage the Debtor.

The Plaintiff seeks damages against the Defendants stemming from these alleged actions in an amount not less than \$15,000,000.00, asking that the Defendants be jointly and severally liable therefor. The Plaintiff bases its demands on the Defendants' alleged breach of fiduciary duty owed to the Debtor, their breach of the Operating Agreement, and their negligent supervision and management of the Debtor. Additionally, the Plaintiff alleges that Ray intentionally or negligently withheld information from the Debtor regarding Ladd's prior criminal background. Finally, the Plaintiff alleges that Ladd converted and/or fraudulently

transferred funds from the Debtor for his own personal use, and he breached his duty of loyalty to the Debtor and the Board.

II

Federal Rule of Civil Procedure 12(b)(6) allows a defendant to move for dismissal of a complaint for “failure to state a claim upon which relief can be granted.” FED. R. CIV. P. 12(b)(6) (applicable in adversary proceedings pursuant to FED. R. BANKR. P. 7012(b)). When faced with a motion to dismiss pursuant to Rule 12(b)(6), courts will “construe the complaint in the light most favorable to the plaintiff, accept all the factual allegations as true, and determine whether the plaintiff can prove a set of facts in support of its claims that would entitle it to relief.” *Bovee*, 272 F.3d at 360. All factual allegations are accepted as true, but the court is not required to accept legal conclusions or unwarranted factual inferences as true. *Mich. Paytel Joint Venture v. City of Detroit*, 287 F.3d 527, 533 (6th Cir. 2002). Instead, the court should focus on “whether the plaintiff has pleaded a cognizable claim[.]” *Marks v. Newcourt Credit Group, Inc.*, 342 F.3d 444, 452 (6th Cir. 2003), and the complaint should not be dismissed “unless it appears beyond doubt that the plaintiff can prove no set of facts in support of [its] claim which would entitle [it] to relief.” *Buchanan v. Apfel*, 249 F.3d 485, 488 (6th Cir. 2001) (quoting *Conley v. Gibson*, 78 S. Ct. 99, 102 (1957)).

Newman and Bush each argue that the Complaint fails to allege specific factual allegations of negligence and/or wrongdoing as to them, individually, and that the non-specific factual allegations do not prove any nexus between them and the alleged negligence

which occurred. Newman argues that the Complaint does not state how he, as Director of Sales and Marketing, owed a duty to the Debtor, which was then breached. Likewise, Bush argues that the Complaint does not set forth how his position as Chief Innovation Officer ties him to the negligence alleged. Therefore, Newman and Bush ask the court to dismiss the Complaint, or in the alternative, to require the Plaintiff to provide a more definite statement.

In its Responses, the Plaintiff states that although it is not required to plead its negligence allegations with specificity, its Complaint more than meets the requirements of Federal Rule of Civil Procedure 8, made applicable to adversary proceedings under Federal Rule of Bankruptcy Procedure 7008, which provides that the Complaint set forth “a short and plain statement of the claim.” FED. R. CIV. P. 8. Similarly, the Plaintiff argues that there is no need for a more definite statement, because the Complaint is not so vague and ambiguous that Newman and Bush cannot reasonably respond.

III

The Debtor’s Complaint avers that the Defendants, including Newman and Bush, breached their fiduciary duty of care to the Debtor, by virtue of their failure to properly oversee the Debtor and their failure to properly perform the duties of their respective offices with the Debtor. As such, the Plaintiff seeks damages in tort against the Defendants, based upon their statutory duties, their common law duties, and their contractual duties by virtue of the Operating Agreement.

In Tennessee, a plaintiff must satisfy the following elements in order to maintain a successful claim for negligence:

(1) a duty of care owed by the defendant to the plaintiff; (2) conduct by the defendant falling below the applicable standard of care that amounts to a breach of that duty; (3) an injury or loss; (4) causation in fact; and (5) proximate, or legal, causation.

Staples v. CBL & Assocs., Inc., 15 S.W.3d 83, 89 (Tenn. 2000).

A duty is defined as “the legal obligation a defendant owes to a plaintiff to conform to a reasonable person standard of care in order to protect against unreasonable risks of harm.”

Staples, 15 S.W.3d at 89; *McCall v. Wilder*, 913 S.W.2d 150, 153 (Tenn. 1995).

The existence of a duty is a question of law for the court which requires consideration of whether ‘such a relation exists between the parties that the community will impose a legal obligation upon one for the benefit of others—or, more simply, whether the interest of the plaintiff which has suffered invasion was entitled to legal protection at the hands of the defendant.’ The imposition of a legal duty ‘reflects society’s contemporary policies and social requirements concerning the rights of individuals and the general public to be protected from another’s act or conduct.’

Turner v. Jordan, 957 S.W.2d 815, 818 (Tenn. 1997) (quoting *Bradshaw v. Daniel*, 854 S.W.2d 865, 870 (Tenn. 1993)). If the court determines that a duty was owed, the focus then shifts to whether the party’s standard of care fell below that of a reasonably prudent person under the same or similar circumstances. See *McCall*, 913 S.W.2d at 153.

As managers of the Debtor, Newman and Bush are bound by the following standard of conduct:

48-241-111. Standard of conduct

(a) General. A manager shall discharge the duties of an office in good faith, in

a manner the manager reasonably believes to be in the best interests of the LLC, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. Notwithstanding anything to the contrary in this section, the articles or operating agreement may define the standard of conduct of the managers in a manner to reflect the understanding of the parties; provided, that such definition is not manifestly unreasonable under the circumstances.

(b) Reliance Permitted. In discharging such duties, a manager is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) One (1) or more managers or employees of the LLC whom the member reasonably believes to be reliable and competent in the matters presented; or

(2) Legal counsel, public accountants, or other persons as to matters the officer reasonably believes are within the person's professional or expert competence.

(c) Where Reliance not Permitted. A manager is not acting in good faith who has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) Limitation on Liability. A manager is not liable for any action taken as a manager, or any failure to take any action, if the manager performed the duties of the office in compliance with this section.

(e) Effect of Delegation. A person exercising the principal functions of an office or to whom some or all of the duties and powers of an office are delegated

pursuant to § 48-241-110^[4] is considered a manager for purposes of this section.

TENN. CODE ANN. § 48-241-111 (2003). The Plaintiff's Complaint sets forth sufficient factual allegations in support of its argument that this statute imposed upon Newman and Bush both a duty of care to the Debtor, as well as set forth the standard therefor.

The Complaint also sufficiently sets forth allegations concerning the losses suffered by the Debtor as a result of the alleged negligence of all of the Defendants, including Newman and Bush, and similarly, is replete with allegations that the actions and inactions of Newman and Bush, together with the other Defendants, are both the cause in fact as well as the proximate cause of the losses suffered by the Debtor.

Although both cause in fact and proximate, or legal, cause are elements of negligence that the plaintiff must prove, they are very different concepts. Cause in fact refers to the cause and effect relationship between the defendant's tortious conduct and the plaintiff's injury or loss. Thus, cause in fact deals with the "but for" consequences of an act. The defendant's conduct is a cause of the event if the event would not have occurred but for the conduct. In contrast, proximate cause, or legal cause, concerns a determination of whether legal liability should be imposed where cause in fact has been established. Proximate or legal cause is a policy decision made by the legislature or the

⁴ Unless prohibited by the articles, the operating agreement, or by a resolution:

(1) Adopted by the affirmative vote of the governors present at a duly held meeting of a board-managed liability company; or

(2) Approved by the affirmative vote of a majority of the membership interest entitled to vote at a duly held meeting of the members of a member-managed LLC;

a manager elected or appointed may, without further approval, delegate some or all of the duties and powers of an office to other persons. A manager who delegates the duties or powers of an office remains subject to the standard of conduct for a manager with respect to the discharge of all duties and powers so delegated.

TENN. CODE ANN. § 48-241-110 (2003).

courts to deny liability for otherwise actionable conduct based on considerations of logic, common sense, policy, precedent and ‘our more or less inadequately expressed ideas of what justice demands or of what is administratively possible and convenient.’

White v. Lawrence, 975 S.W.2d 525, 529 (Tenn. 1998) (quoting *Synder v. LTG Lufttechnische GmbH*, 955 S.W.2d 252, 256 n.6 (Tenn. 1997)).

The court finds that the Complaint sets forth many specific allegations of negligence on the part of Newman and Bush in their operations of the Debtor. Simply because Newman and Bush are not expressly named in each and every allegation does not mean that the Complaint fails to state specific factual allegations. Therefore, taking the pleadings in a light most favorable to the Plaintiff, the court agrees that the Complaint sets forth a claim upon which relief may be granted as to both Newman and Bush, and their Motions to Dismiss shall not be granted.

IV

Likewise, the court does not believe that it is necessary for the Plaintiff to provide Newman and Bush with a more definite statement. Federal Rule of Civil Procedure 12(e), also made applicable to this adversary proceeding by virtue of Rule 7012(b), provides that

If a pleading to which a responsive pleading is permitted is so vague or ambiguous that a party cannot reasonably be required to frame a responsive pleading, the party may move for a more definite statement before interposing a responsive pleading.

FED. R. CIV. P. 12(e). In other words, if a defendant is required to “guess as to what conduct . . . an allegation refers[,]” a more definite statement would be required. *Paragon Fin. Group*,

Inc. v. Bradley Factor, Inc., No. 1:02-CV-222, 2003 U.S. Dist. LEXIS 22105, at *39 (E.D. Tenn. Sept. 15, 2003) (citing *Jackson Nat'l Life Ins. Co. v. Gofen & Glassberg, Inc.*, 882 F. Supp. 713, 726 (N.D. Ill. 1995)).

Here, the Complaint is not so vague and ambiguous that Newman and Bush are required to “guess” what conduct the Plaintiff alleges is negligent. These Defendants are included within a group of “Manager Defendants,” two of whom have filed answers. The Complaint makes specific allegations concerning the actions and inactions of these Defendants as a group; however, Newman and Bush can reasonably frame their responses to the Complaint as to themselves individually. The Plaintiff will not be required to file a more definite statement as to Newman and Bush.

An order consistent with this Memorandum will be entered.

FILED: March 17, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-31932

MEDEX REGIONAL LABORATORIES, LLC

Debtor

THE OFFICIAL UNSECURED CREDITORS COMMITTEE
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Plaintiff

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T. ARTHUR SCOTT, and PAUL J. SIDES

Defendants

ORDER

For the reasons set forth in the Memorandum on Motions of Defendants Stephen Newman and Edward G. Bush to Dismiss for Failure to State a Claim Upon Which Relief May Be Granted, or in the Alternative, Motions for More Definite Statement filed this date, the court directs the following:

1. The Motion of Defendant Stephen Newman to Dismiss for Failure to State a Claim Upon Which Relief May Be Granted, or in the Alternative, Motion for More Definite Statement filed by the Defendant Steven [sic] Newman on February 27, 2004, is DENIED.

2. The Motion of Defendant Edward G. Bush to Dismiss for Failure to State a Claim Upon Which Relief May Be Granted, or in the Alternative, Motion for More Definite Statement filed by the Defendant Edward G. Bush on February 27, 2004, is DENIED.

SO ORDERED.

ENTER: March 17, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE